

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-88 (24)C
Corporation Tax
October 24, 1988

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C880726B

On July 26, 1988, a Petition for Advisory Opinion was received from Jamaica Water Supply Company, 410 Lakeville Road, Lake Success, New York 11042.

The issue raised is whether a reasonable amount for bad debts is allowed when computing taxable income under section 186 of the Tax Law.

Petitioner is an accrual basis taxpayer. Petitioner states that when computing gross income under section 186-a of the Tax Law, an exclusion is allowed for a reasonable amount of bad debts. Petitioner states that by allowing the exclusion for bad debts, an accrual basis taxpayer is achieving the same results as would be attained by the cash system of accounting and reporting.

Petitioner contends that the intent of section 186 of the Tax Law is to tax receipts realized and that in the case of an accrual basis taxpayer, the allowance for a reasonable amount of bad debts is necessary in order that the taxes computed are based on revenue "received". In the absence of a bad debt deduction, Petitioner contends that the taxes may be computed and paid on receipts not realized. Petitioner believes that the term receipts, as used in section 186, was intended to mean receipts received which would allow an accrual basis taxpayer an exclusion for bad debts.

When cash basis accounting is used, revenue is not recognized when the exchange transaction occurs, but rather only when the cash is collected. Similarly, expenses are not recognized when they are incurred as a result of an exchange transaction, but rather only when the cash payment is made. Accrual basis accounting is specified by the revenue and matching principles. Under the revenue principle, revenue is considered realized (i.e., earned), and is recognized in the accounts and reports, in the period in which the transaction occurs, regardless of the periods in which the related cash is collected. Similarly, under the matching principle, an expense is recognized, and matched with the revenue of the period to which it relates, regardless of when the related cash is expended. (G. Welsch, C. Zlatkovich, J. White, Intermediate Accounting, 33 (4th ed. 1976)).

The Tax on the Furnishing of Utility Services Regulations, promulgated pursuant to section 186-a of the Tax Law, specifically allow a deduction for bad debts when a taxpayer uses the accrual method of accounting so that the results for such taxpayer would be substantially similar if not exactly the same as a cash method taxpayer. Section 501.2 of such regulations provides that:

[a] utility keeping its accounts on the accrual basis shall include in gross income all receipts accrued on its books for the reporting period, but will be permitted to deduct such sums as represent, for example, uncollectible accounts, returned merchandise, etc., regardless of when the sales were made or services rendered, thus achieving substantially, if not exactly, the

same results as would be attained by the cash system of accounting and reporting.

Section 186 is distinguished from section 186-a in that section 186 does not attempt to eliminate the differences in accounting for income resulting from the use by a taxpayer of the accrual method versus the cash method of accounting.

Section 186 of the Tax Law imposes a franchise tax upon every corporation, joint-stock company or association formed for or principally engaged in the business of supplying water, steam or gas "for the privilege of exercising its corporate franchise or carrying on its business in such corporate or organized capacity in this state". The tax imposed consists of two parts, a gross earnings tax and an excess dividends tax. Only the earnings tax is pertinent to the issue raised herein.

In its original form, section 186 provided for a franchise tax upon various types of utility companies measured by their "gross earnings from all sources within this state." In interpreting the statute, the Appellate Division held in 1906 that in order to arrive at gross earnings, the cost of raw materials used in producing the utility service had to be deducted from the company's gross receipts (People ex rel. Brooklyn Union Gas Co. v. Morgan, 114 App Div 266). In 1907, the legislature amended section 186 by adding the following definition: "The term 'gross earnings' as used in this section means all receipts from the employment of capital without any deduction" (L 1907, ch 734, S 3). Shortly thereafter, the Court of Appeals, construing the new amendment, found that its purpose was "to enlarge the scope of the franchise tax by including all moneys that were received as products of all uses of corporate capital, 'without any deduction'" (People ex rel. Westchester Light Co. v. Gaus, 199 NY 147, 149). Almost sixty years later, the Court held that the amendment did not contemplate a substitution of "gross receipts" for "gross earnings" as the basis for taxation; rather it "merely sought to include [in gross earnings]... that portion of 'gross earnings' which represents the 'employment of capital' to manufacture, distribute and sell various public utility services" (Matter of Consolidated Edison v. Tax Commn., 24 NY2d 114, 119).

Section 186 specifically states that gross earnings means "all receipts from the employment of capital without any deduction" (emphasis added). There are no regulations promulgated under section 186. However, it is clear from the legislation and the decisions of the courts that it was not the intent to allow a deduction for bad debts for taxpayers using the accrual method of accounting when such taxpayers determine gross earnings under section 186.

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Accordingly, Petitioner may not deduct a reasonable amount for bad debts when computing taxable income under section 186 of the Tax Law, even though a deduction for a reasonable amount for bad debts is allowed under section 186-a of the Tax Law.

DATED: October 24, 1988

s/FRANK J. PUCCIA
Director
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions
are limited to the facts set forth therein.